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CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1932.
No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,
(A Corporation), Petitioner

vs.

THE UNITED STATES.

PETITION OF PETITIONER FOR RE-HEARING.

GUY PATTEN,
A. R. SERVEN,
Counsel for Petitioner.

PRESS OF THE SUDWARTH COMPANY, WASHINGTON

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PETITION FOR RE-HEARING.

Comes now the above named petitioner, the Massachusetts Mutual Life Insurance Company, and presents this, its petition for a re-hearing of the above entitled cause, and, in support thereof, respectfully shows:

That the opinion of this Honorable Court in this cause was rendered on February 6, 1933.

That this Honorable Court, upon the first issue, having held that petitioner is required to make its income tax returns upon the cash receipts and disbursements method of accounting and is therefor entitled to only such deduction for interest paid as other taxpayers similarly situated, there remained the question, whether, the petitioner is entitled to the deduction from gross income of all

interest unconditionally credited to its policyholders during the taxable year subject to withdrawal on demand, as interest "paid." Upon this issue, in considering the application of Article 51 of Regulations 69, which provides:

> "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession,"

this Honorable Court reached the conclusion from the information before it that—

> "This regulation has, however, not been applied in any case where income has been credited to another by a taxpayer employing the cash receipts and disbursements method of accounting; and specifically it has not been invoked to require policyholders to report as income the dividends or interest credited to them in cases such as this. No tax is demanded of them until actual receipt of the money. The constructive payment theory is, we think, untenable."

This case was heard by this Honorable Court on January 16th and 17th, 1933. At that time it was impossible for the petitioner to aid the court in the matter of information relative to the administrative application of the law and said regulation to the facts in the cases such as this, because such information is only available to petitioner through the published rulings and decisions of the Bureau of Internal Revenue. No such ruling or decision, so far as known to petitioner, had ever been published at the time this case was heard.

However, since the trial of this case an opinion of the General Counsel, Bureau of Internal Revenue, has been published in the Internal Revenue Bulletin of January 30, 1933, Vol. XII, No. 5, at Page 1, which opinion relates to the application of Article 322 of Regulations 74 under the Revenue Act of 1928. The provision of the regulation is: "*A taxpayer is deemed to have received items of gross income which have been credited or set apart for him without restriction.*" (Italics ours). The opinion holds that a taxpayer, which keeps its books on the cash receipts and disbursements basis, may deduct the amount of interest actually credited to the accounts of its depositors and the depositors must report such interest as income. Said opinion is set forth in full at Page 9 of the Appendix hereto. Attention is respectfully called to that part of the opinion (Appen. p. 11) in which the case at bar, as decided by the Court of Claims, is contrasted. We feel it is apparent that the General Counsel in making such comparisons fell into error with reference to the provisions of the policy contracts under which (Fdg. 8, R. 14-15) the dividends are held by the company to accumulate at interest only in the event the policyholder either so elects or the account is thus settled by his failure to withdraw them in cash or otherwise use them. This constitutes the settlement. Thereafter they are subject to the disposition of the policyholder and not the company. In the paragraph following wherein the General Counsel says—

> "In the case of bank accounts, such as those involved in the instant case, the crediting of interest to the account of the depositor and the striking of a new balance upon which in-

> terest thereafter is computed constitutes, in the opinion of this office, a result that must be regarded as conclusive, since the account can not be reopened by a party seeking a different result except by mutual agreement or by clear and satisfactory evidence of error, fraud, or mistake;"

he states a set of facts exactly parallel to the facts in the case at bar. In the instant case, when interest on dividends left is credited to the policyholder, instead of being withdrawn by him in cash or otherwise applied, it immediately becomes a part of the fund upon which interest thereafter is computed.

Your petitioner further shows that since this case was tried before this Honorable Court the Commissioner of Internal Revenue on January 27, 1933, in a ruling made by him held that when the amount called for by a policy of life insurance, under an option therein, is left with the company at interest "The amount thereon credited to the beneficiary as interest constitutes taxable income to the beneficiary for the year in which it is credited, inasmuch as such interest is subject to his demand." This ruling it appears reaffirms a ruling to the same effect made as early as November 10, 1927. The aforesaid ruling was published in the Prentice-Hall Federal Tax Service, in its issue of February 9, 1933, Vol. 1, Page 17. Said ruling is set forth in full in the Appendix hereto at page 13. It would seem there can be no difference in principle between the character of interest on amounts called for by a policy of life insurance which are left by the beneficiary with the company at interest, and interest on dividends called for by such a policy which are left with the com-

pany by the insured at interest, because in neither case is the interest exempt from taxation. It is only the dividends (which represent a return of premiums), or other amounts called for by the policy, as pointed out by the Commissioner of Internal Revenue in the above opinion, that the statute exempts. Both are in accord with Article 47 of Regulations 69 under the Revenue Act of 1926, which provides:

> "Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called "dividends" of a mutual insurance company which may be credited against the current premium, are not subject to tax."

It is unfortunate that petitioner was unable to give the court the benefit of the aforesaid rulings at the time this case was tried, as it is believed if the court had been fully so advised its conclusion upon this question might have been different.

For the foregoing reasons, it is respectfully urged that this petition for a re-hearing be granted, and that the judgment of the Court of Claims be, upon further consideration, reversed.

Respectfully submitted,

GUY PATTEN,
A. R. SERVEN,
Counsel for Petitioner.

Certificate of Counsel.

I, Guy Patten, Counsel for the above named petitioner, do hereby certify that the foregoing petition for a re-hearing of this cause is presented in good faith and not for delay.

GUY PATTEN,
Counsel for Petitioner.

APPENDIX.

Revenue Act of 1928.

SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

XII-5-6008.
G. C. M. 11348.

Article 332: Income not reduced to possession.

REVENUE ACT OF 1928.

> Where a bank, which keeps its books on the cash receipts and disbursements basis, sets up a reserve each month for the estimated amount of interest due on savings accounts, known as "time deposits," the accrual of interest in the so-called reserve account does not constitute such interest a deductible item. The bank may deduct only the amount of interest actually credited to the accounts of its time depositors, and the depositors must report such interest as income.

An opinion is requested relative to the application of the provisions of Article 332 of Regulations 74 in determining the amount of interest which may be deducted from the gross income of the M Company in connection with a proposed deficiency against the taxpayer for the year 1930.

The facts as set forth in the taxpayer's protest are as follows:

> This taxpayer is in the banking business at the city of X, State of Y, and has on deposit various sums in savings accounts, otherwise known as "time deposits." During the year 1930 these savings accounts were about x dollars. Interest was payable upon these accounts during this year at the rate of 4 per cent per year. At the end of each calendar

month the bank set up as a reserve the estimated amount of interest due on these accounts for that month. Once each six months the amount of interest due upon each individual account was entered as a credit to that individual account, and charged against the reserve theretofore set up. Up to and including the year 1929 these entries to the individual accounts had been made June 30 and December 31. In 1930 entries were made to the individual accounts for three months on April 1, 1930, and for six months' interest on October 1, 1930.

This interest is not paid out to the individual depositors, except at such time as they call for and withdraw their savings accounts. When such call is made, the depositor is paid the full amount of the interest up to the date of withdrawal, whether such date be on a day when credit is regularly made to his account (which would be a rare coincidence) or otherwise. The handling of the interest is altogether a matter of bookkeeping entries.

Taxpayer's returns were upon a cash receipts and disbursements basis. On its return for the year 1930 taxpayer deucted interest for 12 months on these saving accounts. * * *

The taxpayer states that at the end of each month a bookkeeping entry is made setting up accrued interest in a reserve account. Twice each year another bookkeeping entry is made setting up the interest in the account of the individual depositor. According to the taxpayer's brief, "He (the depositor) may come in any day that he pleases (after furnishing the requisite notice, if

his deposit is a time deposit) and interest up to that day is subject to his withdrawal, no matter what day it happens to be."

The opinion of this office is requested relative to the application of the decision of the Court of Claims in the case of the *Massachusetts Mutual Life Insurance Co.* v. *United States* (59 F. (2d), 116, Ct. D. 563, Bulletin XI-38, 14) to the instant case, with specific reference to the following questions:

> (a) Whether the taxpayer is entitled to deduct from its gross income the total amount of interest actually credited to the accounts of its time depositors during the year 1930;
>
> (b) If the preceding question is answered in the negative, when is such interest deductible from the gross income of the taxpayer; and
>
> (c) If the answer to the first question is in the negative when are the time depositors required to report in gross income the interest credited to their accounts.

In the case of *Massachusetts Mutual Life Insurance Co.* v. *United States*, supra, it was held that a life insurance company, required by law and regulations to use the cash basis of accounting as distinguished from the accrual basis, may not deduct in 1926 interest credited to its policyholders in 1926 under the terms in the policies, although the policy contracts provided that the interest was subject to withdrawal on demand, and the policyholders were notified during the year of the amount of interest so credited. In its opinion the Court of Claims used the following language:

> Other than in the administration of es-

> tates or trusts, as to which the statute specifically provides for a deduction of credits under certain circumstances, we know of no instance, and none has been cal ed to our attention, in which it has been held that an amount credited but not paid by a taxpayer employing the cash receipts and disbursements method of accounting constitutes income to the person to whom credited. It is not claimed that the interest credited by the plaintiff to its stockholders during 1926 was taxed as income to them in that year by the Commissioner. To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is therefore deductible from gross income in the year in which credited, would destroy the distinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes. * * *

It is clear that the accrual of interest in the so-called reserve account does not constitute such interest a deductible item in the case of a taxpayer whose books of account are kept on the cash receipts and disbursements basis. Here the only question to be determined is the status of the interest actually credited to the accounts of depositors, *i.e.*, whether the interest so credited may be considered as interest paid within the taxable year. It appears that the interest is credited on the depositors' accounts twice annually, at specified dates, instead of being paid in cash or by check, pursuant to an understanding or agreement between the bank and the depositors; and that the amount of the interest so credited be-

comes a part of the principal sum and bears interest from the date of the credit.

In banking the general rule in keeping the account of a depositor is that as money is paid in and drawn out a balance may be considered as struck at the date of each payment or entry, on either side of the account. *(Wasson* v. *Lamb,* 22 N. E. 729). It is, of course, necessary that the bank should keep a correct entry in its books. Frequently depositors make use of what is known as the "pass book," in which entries are made corresponding to the entries made in the depositor's account on the books of the bank, and a balance is struck. From the entries thus made by the banker, the depositor is apprised of the state of his account. Such entry in the pass book is in effect an account stated between the bank and its depositor. *(Greenhalgh Co.* v. *Farmers' National Bank,* 226 Pa., 184, 134 Am. S. R. 1016, 75 Atl., 260). In a note on this subject appearing in 134 Am. S. R., 1022, the law is stated as follows:

> * * * Entries in a depositor's pass book striking a balance coupled with the delivery of the book to him, without objection on his part, constitute an account stated. *(Clark v. Mechanics' National Bank,* 11 Daly, 239; *August v. New York Fourth National Bank,* 1 N. Y. Supp., 139; *Leather Manufacturers' National Bank v. Morgan,* 117 U. S. 96, 6 Sup. Ct. Rep. 657, 29 L. Ed. 811.) And the proposition stands even on a firmer base, if, as is often done, the bank has returned to the customer his checks with the account of the balance. * * * *The mere fact that the account contains interest charges for which, of course, no checks have been drawn, does not impair the status of the account. (Schoonover*

v. Osborne, 108 Iowa, 453, 79 N. W., 263). (Italics supplied).

In the Massachusetts Mutual Life Insurance Co. case, supra, the amounts credited to the policyholder's account do not become income to him until he elects to exercise the option afforded under the policy contract of taking the same in cash, rather than to permit it to remain subject to the disposition of the company under the terms of the policy contract.

In the case of bank accounts, such as those involved in the instant case, the crediting of interest to the account of the depositor and the striking of a new balance upon which interest thereafter is computed constitutes, in the opinion of this office, a result that must be regarded as conclusive, since the account can not be reopened by a party seeking a different result except by mutual agreement or by clear and satisfactory evidence of error, fraud, or mistake. *(See Chappedelaine* v. *Dechenaux*, 4 Cranch, 306, and other cases cited therein).

The crediting of interest to policyholders on the books of an insurance company in no sense presents a situation parallel to that under consideration in the instant case where a bank by crediting interest on certain agreed due dates to the accounts of its depositors, in effect "deposits" the amount of the interest to such accounts. It would seem, on the contrary, that the credits involved in the instant case, constitute, both for legal and practical purposes, that kind of deposit, peculiar to the banking business, in which the depositor, for his own convenience, parts with the title to his money and loans it to the banker; and the latter, in consideration of the loan of the money and the

right to use it for his own profit, agrees to refund the same amount or any part thereof, on demand. (See *Marine Bank* v. *Fulton Bank*, 2 Wall. (U.S.), 252, 256). The only apparent difference between this and the ordinary deposit is that, by agreement or mutual understanding for the convenience of both parties, the formality of payment by cash or check and the actual deposit thereof by the depositor are dispensed with; and, as stated in 5 Cyc., 517 (IV):

> The law presumes that a deposit belongs to the person in whose name it is entered and the bank can not question his right thereto.
> * * * When money is deposited in a bank it is said to be the debtor and the depositor the creditor. Yet in another sense the depositor is the owner and can at any time demand repayment. * * *

Moreover, the principles of law applicable to deposits, in so far as the status of credits to accounts of bank depositors are concerned for income tax purposes, appear to be the same whether the accounts relate to time deposits, checking, or savings accounts, where the amount of such credits becomes immediately available to the depositor or owner of the account.

Accordingly, it is the conclusion of this office that the taxpayer is entitled to deduct from its gross income only the amount of interest actually credited to the accounts of its time depositors during the year 1930, and the depositors must report such interest as income.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal Revenue

JANUARY 27, 1933.

Address Reply to
Commissioner of Internal Revenue

Sir:

Reference is made to your letter dated November 9, 1932, furnishing additional information for consideration in connection with your previous request for reconsideration of the Rulings made by Office Letters of November 10, 1927, and February 28, 1928, relative to the status for income tax purposes of the amounts received or to be received upon the death of the insured as the proceeds of insurance policies issued by the * * * Insurance Company in behalf of which the question is presented by you.

Reconsideration of such rulings is requested in view of the ruling made by Office Letter of August 15, 1932, pertaining to the amount payable as the proceeds of the policy designated as the "Family Income Policy—20 Year Period." Under that policy on a $10,000.00 basis the company pays the beneficiary $100.00 a month from the date of death of the insured to the expiration of the period of twenty years from the date on which the policy was issued, and the amount of $10,000.00 is payable in cash at the expiration of such period. Although the amount of $10,000.00 would of course earn income in the hands of the company from the date of the death of the insured to the date of payment to the beneficiary, the withholding of payment of such amount was held to be one of the things contracted for and acquired by the insured

as consideration for the premium payments made as the cost of the policy. While the periodic payments made to the beneficiary would appear to represent in part earnings on the deferred payments, such payments were held to constitute a part of the proceeds of the policy payable by reason of the death of the insured, and the entire amount received or to be received by the beneficiary was held to be exempt from the income tax under Section 22 (b) (1) of the Revenue Act of 1932 and the corresponding sections of the prior acts.

Your present inquiry pertains to a policy calling for the payment of the specified amount or amounts to the designated beneficiary or beneficiaries upon the death of the insured in accordance with one of five optional methods of settlement set out in the policy. The amount of the respective payments to be made is based on each $1,000.00 of insurance carried by the insured at the date of death. If no method of settlement is designated by the insured prior to his death, it appears that such selections as to the various methods may be made by the beneficiary. In such case, however, the principal sum or face amount of the policy is obviously available to the beneficiary upon the death of the insured and such amount constitutes the proceeds of the policy regardless of the arrangement made by the beneficiary as to the method of payment. The question presented therefore pertains to cases where the method of settlement is designated by the insured prior to his death. The five optional methods designated by Numbers 1 to 5 are summarized as follows:

1. The amount called for by the policy is left

with the company subject to withdrawal at any time in sums of not less than $100.00. While so left with the company interest is payable thereon at an annual rate of not less than 3%.

2. Under this option the amount of the proceeds is payable in equal periodic installments over a period not to exceed 30 years.

3. Under this option a monthly of other periodic amount is payable to the beneficiary for life with payment of such amount guaranteed for a specified period not to exceed 20 years.

4. Under this option the amount called for by the policy is held by the company and payments are made to the present or immediate beneficiary at an annual rate of not less than 3% if paid annually or at a slightly lower rate if payments are made at shorter intervals.

5. Under this option the amount called for by the policy is left with the company under an arrangement for payment to be made to the beneficiary in equal periodic installments with provision that the amount payable each year is not to be less than 5% of the amount originally left with the company.

Under options 4 and 5 any amount remaining at the date of death of the beneficiary is payable to his estate unless otherwise agreed to in writing although it appears that any disposition in this respect is required to be made by the insured and not by the beneficiary. It is also to be observed that where settlement is made by deferred payments the total amount payable is in excess of the principal sum or face amount of the policy. Thus under option 2 where payments are to be made over a period of 10 years it is observed that for each $1,000.00 of insurance the total payments

to be received if made annually aggregate $1,138.10.

In reply you are advised that where option 1 is so designated by the insured the amount called for by the policy is subject to withdrawal by the beneficiary although it may be voluntarily left with the company by him. The amount of the proceeds under this option is therefore the amount called for by the policy, and the amount thereon credited to the beneficiary as interest constitutes taxable income to the beneficiary for the year in which it is credited inasmuch as such interest is subject to his demand. The ruling made by Office Letter of November 10, 1927, with respect to settlement made under this option is therefore reaffirmed.

Under the other or remaining four options the method of payment is fixed or designated by the insured prior to his death and is not subject to change by the beneficiary. The principles to be applied with respect to settlement made under these options are therefore those set out in the Ruling published as G. C. M. 10843 in Internal Revenue Bulletin Vol. XI, No. 43, page 2. As therein set out any system of deferred payments ordinarily involves the element of interest. This is of course true in any case where payment is made in installments but regardless of that fact the entire amount payable as the proceeds of the policy where payment is made in installments is exempt from the income tax by the express provisions of the statute.

Under each of these four options where the method of settlement is designated by the insured all amounts received under the method selected are of course received as consideration for the amount of the premium payments as the cost of

the policy. Where such elections or designation is made by the insured all amounts received in settlement upon the death of the insured therefore go to form a part of the amount paid or to be paid by reason of the death of the insured under Section 22 (b) (1) of the Revenue Act of 1932 and the corresponding provisions of the prior Acts. Regardless of whether such payment be made to a single beneficiary, to a first and second beneficiary, or to a beneficiary and his estate, the entire amounts so received are accordingly held to be wholly exempt from the income tax, and the rulings made by Office Letters of November 10, 1927, and February 28, 1928, are modified accordingly.

Respectfully,

(Signed) DAVID BURNET,

Commissioner.